The Honorable Marsha J. Pechman

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON

IN RE WASHINGTON MUTUAL MORTGAGE BACKED SECURITIES LITIGATION, This Document Relates to: ALL CASES	MASTER CASE NO. C09-037 MJP **DEFENDANTS' MOTION TO EXCLUDE THE PROFFERED EXPERT TESTIMONY OF CHARLES D. COWAN AND IRA HOLT** NOTE ON MOTION CALENDAR: May 11, 2012 ORAL ARGUMENT REQUESTED

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EXPLANATION OF CITATION FORMS

The following citation forms are used in this memorandum:

- "Cowan Report" for references to the Expert Report of Plaintiffs' proposed expert, Dr. Charles D. Cowan, dated March 2, 2012 (Earnhardt Decl. Ex. 1).
- "Holt Report" for references to the Expert Report of Plaintiffs' proposed expert, Ira Holt, dated March 2, 2012 (Earnhardt Decl. Ex. 2).
- "Ostendorf Report" for references to the Expert Report of Defendants' proposed expert, George Ostendorf, dated March 30, 2012 (Earnhardt Decl. Ex. 3).
- "Wecker Report" for references to the Expert Report of Defendants' proposed expert, Dr. William Wecker, dated March 30, 2012 (Earnhardt Decl. Ex. 4).
- "Holt Survey" for references to the survey template that Mr. Holt states he and his team utilized in conducting their reunderwriting review (Earnhardt Decl. Ex. 5).
- "Holt Survey Data" for references to the data that Mr. Holt states he and his team compiled through the use of the Holt Survey (Earnhardt Decl. Ex. 7).
- "8/17/06 CUG" for references to the version of WMB's Conventional Underwriting Guidelines dated August 17, 2006 (Earnhardt Decl. Ex. 8).
- "8/17/06 PPG" for references to the version of WMB's Product and Pricing Guide dated August 17, 2006 (Earnhardt Decl. Ex. 9).
- "Pls. 12(c) Opp." for references to Plaintiffs' Opposition to Defendants' Motion for Judgment on the Pleadings (Docket No. 327) (Earnhardt Decl. Ex. 10).

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Defendants WaMu Capital Corp. ("WCC"), WaMu Asset Acceptance Corp. ("WAAC"), David Beck, Diane Novak, Rolland Jurgens and Richard Careaga respectfully submit this motion to exclude the proffered expert testimony of Dr. Charles D. Cowan and Ira Holt.

PRELIMINARY STATEMENT

The central issue in this case is whether the Offering Documents for the Certificates purchased by Plaintiffs contained material misstatements concerning Washington Mutual Bank's ("WMB") mortgage underwriting (i.e., the process by which WMB determined whether to approve mortgage loan applications). In re Washington Mutual Mortgage Backed Securities Litigation, 748 F. Supp. 2d 1246 (W.D. Wash. 2010). As the Court explained it: "In essence, Plaintiffs allege the underwriting guidelines ceased to exist. If proven true, the absence of underwriting standards could make the identified statements misleading." Id. at 1255.

In support of their claim, Plaintiffs submitted reports of two purported experts—Dr. Charles Cowan and Mr. Ira Holt—who together opine that 37.1 percent of the loans backing the securitizations at issue were "materially defective". (Cowan Report at 2; Holt Report at 3.) To arrive at that opinion, Dr. Cowan (Plaintiffs' proposed statistical sampling expert) selected a sample of loans, and Mr. Holt (Plaintiffs' proposed underwriting expert) reviewed a subset of the loans in Dr. Cowan's sample. (Plaintiffs also submitted reports from other experts on separate issues that are not the subject of this motion, and Defendants reserve the right to move to exclude the proffered testimony of Plaintiffs' other experts at a future date.)

After Mr. Holt re-underwrote the loans in that subset, Dr. Cowan extrapolated Mr. Holt's conclusions about those loans to the broader population. Because each expert's analysis is dependent on the other, Dr. Cowan and Mr. Holt must each have

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employed a reliable methodology in order for the testimony of either expert to be admissible.

The testimony of both experts should be excluded for multiple independent reasons. First, the sample of loans reviewed by Mr. Holt was fundamentally flawed because it was not randomly selected. A valid random sampling technique must by definition assign some non-zero probability of selection to each member of the sampled population. While Dr. Cowan purported to select a random sample from the total loan population, in fact his methodology excluded nearly 1,500 loans, giving them a zero possibility of being chosen for the sample, which is a textbook error that invalidates any attempt to extrapolate the alleged characteristics of the sample to the overall loan population. Further, Mr. Holt's selection of the subset of loans to review from Dr. Cowan's sample was also not random, was not the result of any scientific methodology, missed large swaths of the relevant loan population and yielded a severely biased set of loans. (See Argument § II.) Second, even assuming his sample was appropriately chosen—and it was not—Mr. Holt's re-underwriting process was flawed, unreliable and irrelevant because, despite claiming to do so, he failed to apply the WMB guidelines, the adherence to which is purportedly the subject of his opinion. (See Argument § III.)

BACKGROUND

Dr. Cowan and Mr. Holt employed a multi-step process to opine that 37.1 percent of the loans underlying the securities at issue were "materially defective".

First, Dr. Cowan selected a sample of 2,387 loans out of the 13,425 loans backing the six securitizations at issue. (Cowan Report at 4; Wecker Report at 2.) To select his sample, Dr. Cowan divided the loans in each securitization into "strata" based on FICO score and loan-to-value (LTV) ratio. (Cowan Report at 5-7.) He then arranged the loans in each stratum by loan number and selected a portion of those loans for his

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sample through a process called "interval sampling", whereby every "n^{th}" loan following the first randomly selected loan was included in the sample. (Wecker Report at 9-10.) For instance, in one stratum, Dr. Cowan randomly selected a loan from among the first four loans in the sorted list and then selected every 4.528735632^{th} loan following the first chosen loan. (Id. at 10-11.) However, because the interval (4.528735632) was greater than the number of possibilities for the starting point (four), as a matter of mathematical fact, there were several loans in that stratum that were assigned zero probability of selection. (Id.) For example, regardless of which loan among the first four was the starting point, given Dr. Cowan's chosen interval it was impossible for the fifth loan in that stratum to be selected. (Id.) Dr. Cowan repeated the same error in the vast majority of the strata in his sample, which meant that numerous loans from the total population—indeed, 1,492 loans, or 11.1 percent—had zero chance of being included in Dr. Cowan's sample at all. (Id. at 11-12.)

Second, Dr. Cowan's sample was "sent to Mr. Holt for re-underwriting". (Cowan Report at 7.) However, Mr. Holt did not re-underwrite all 2,387 loans, but instead reviewed only 424 loans from Dr. Cowan's sample. (Id. at 7, 10.)

No explanation was provided for why Mr. Holt did not review Dr. Cowan's entire sample or how he selected the 424 loans that he reviewed. However, even a cursory review of the 424 loans proves they were not randomly selected. The 424 loan subset does not include any loans from six of the nineteen loan groups underlying the securitizations at issue and from 193 of the 303 strata into which Dr. Cowan divided the loans. (Wecker Report at 20.) If selected randomly, the probability that at least one loan from the 110 strata completely missed by Mr. Holt would have been included among the 424 loans is 0.9999999999 (followed by 173 more 9's). (Id. at 20-21.) Indeed, the probability that Mr. Holt's 424 loans are a random subset of Dr. Cowan's initial sample is

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unfathomably low—less than one in 10^{140}. (Id. at 7, 21.)

Not only was the 424 loan sample not random, it was also biased. However Mr. Holt chose that subset of 424 loans, a disproportionate number came from the quartile with the lowest FICO scores, which significantly inflated the number of loans that he deemed "materially defective". (Wecker Report at 22.)

Third, Mr. Holt stated that he re-underwrote the 424 loans in accordance with WMB's underwriting guidelines. (Holt Report at 2.) To do that, Mr. Holt designed a survey that his team of re-underwriters used to record information about each loan. (Id. at 15-16.) Mr. Holt then reviewed the information compiled in the survey and opined whether each loan was "materially defective", i.e., whether, in his view, the "loan deviated from the applicable Guidelines in a way that materially increased the risk of the loan". (Id. at 3.) Based on that review, Mr. Holt concluded that 178 out of the 424 loans in his sample were "materially defective". (Holt Survey Data, Sheet 2; Ostendorf Report ¶ 110.) In analyzing each loan, however, Mr. Holt applied (or required his team to apply in completing the survey) a number of "rules" that are inconsistent with, and in some cases directly contradict, what was prescribed by the WMB underwriting guidelines in place at the time (the details of which are described below at pp. 11-16).

Fourth, Mr. Holt sent his conclusions back to Dr. Cowan who extrapolated those findings to the broader loan population. (Cowan Report at 2.)

ARGUMENT

I. Applicable Legal Standards.

District courts must exercise a "gatekeeping role" and only allow proffered expert testimony if: "[1] the testimony is based on sufficient facts or data; [2] the testimony is the product of reliable principles and methods; and [3] the expert has reliably applied the principles and methods to the facts of the case". Fed. R. Evid. 702;

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Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579, 595 (1993); see also Many Cultures, One Message v. Clements, No. 10-CV-05253, 2011 WL 5515515, at *18-19 (W.D. Wash. Nov. 8, 2011) (listing factors to be considered in determining reliability) (quoting Henricksen v. ConocoPhillips Co., 605 F. Supp. 2d 1142, 1154 (E.D. Wash. 2009) ("The trial court's gatekeeping function requires more than simply taking the expert's word for it."). "[I]t is the proponent of the expert witness—not the objecting party—who has the burden of proving admissibility" by a preponderance of the evidence. Many Cultures, 2011 WL 5515515, at *15. Those requirements must be satisfied for every step in an expert's analysis. Id. at *18; In re Silicone Gel Breast Implants Prods. Liab. Litig., 318 F. Supp. 2d 879, 890 (C.D. Cal. 2004) ("any step that renders [the expert's] analysis unreliable . . . renders the expert's testimony inadmissible").

With respect to relevance, a proffered expert's testimony must be excluded unless "the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue". Fed. R. Evid. 702. According to the Ninth Circuit, "Daubert stressed the importance of the 'fit' between the testimony and an issue in the case: 'Rule 702's "helpfulness" standard requires a valid scientific connection to the pertinent inquiry as a precondition to admissibility.'" Daubert v. Merrell Dow Pharm., Inc., 43 F.3d 1311, 1320 (9th Cir. 1995) (quoting Daubert, 509 U.S. at 591-592).

II. Dr. Cowan and Mr. Holt Should Be Precluded From Testifying Because They Selected a Non-Random, Biased Sample of Loans for Re-Underwriting.

Where an expert purports to use the condition of a sample to draw conclusions about a larger population, those conclusions can only be deemed reliable if the sample is selected in a random manner. Certified Eng'g Copier Sys., Inc. v. Nat'l City Commercial Capital Co. LLC., No. 2:07-CV-293 TS, 2009 WL 1324047, at *5 (D.

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Utah May 11, 2009); see also Chavez v. IBP, Inc., No. CV-01-5093-RHW, 2004 WL 5520002, at *8-11 (E.D. Wash. Dec. 8, 2004) (excluding expert's extrapolated conclusions where the expert "did not engage in random sampling"); Radaszewski v. Maram, No. 01-C-9551, 2008 U.S. Dist. LEXIS 24923, at *29 (N.D. Ill. Mar. 26, 2008) ("Non-random judgmental sampling could not be used to reliably extrapolate . . ."). While "[t]rained experts commonly extrapolate from existing data", the Supreme Court has held that an expert should be excluded if the Court "conclude[s] that there is simply too great an analytical gap between the data and the opinion proffered". General Elec. Co. v. Joiner, 522 U.S. 136, 146 (1997). Dr. Cowan concedes that his ability to extrapolate Mr. Holt's re-underwriting results for a sample of loans to the broader population of loans at issue depends upon the "mechanism of randomization". (Cowan Report at 9.)

A mere "attempt at randomness" is not enough. Certified Eng'g, 2009 WL 1324047, at *5. The party offering the expert testimony must show that the sample was "statistically random". Id. "It is randomness in the technical sense that provides assurance of unbiased estimates from a randomized controlled experiment or a probability sample. . . . Looser definitions of randomness are inadequate for statistical purposes." Kaye and Freedman, "Reference Guide on Statistics" in Federal Judicial Center's Reference Manual on Scientific Evidence, 230 (3rd ed. 2011).

Thus, only by selecting a statistically valid random sample can Mr. Holt's opinion be applied to the over 13,000 loans he did not look at. Without reliable extrapolation, Mr. Holt's opinion regarding a sample of 424 loans (out of the 13,425 loans total) fails Rule 702's "helpfulness" test and is not admissible for purposes of determining whether WMB's underwriting guidelines "ceased to exist". See Daubert, 43 F.3d at 1320. Quite to the contrary, Mr. Holt's opinion would be highly prejudicial (and

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thus also violate Rule 403) because it would likely be perceived by the jury as a conclusion that could be extrapolated to the broader population.

For reasons apparent from Dr. Cowan's and Mr. Holt's reports, the sample of 424 loans reviewed by Mr. Holt was not random. Those 424 loans were selected from the total population in two steps. At each step, the proposed experts failed to choose a valid random sample. Each failure independently renders their testimony inadmissible.

First, the process Dr. Cowan utilized to select the initial sample of 2,387 loans did not yield a statistically valid random sample. (See Wecker Report at 4-5 & Appx. A.) It is a bedrock principle of statistical sampling that each member of the population sampled must have some non-zero probability of being included in the sample; otherwise, the sample is not random. See Reference Manual on Scientific Evidence, at 225. Contrary to that basic principle, Dr. Cowan assigned a "zero" probability of selection to over eleven percent of all loans underlying the securitizations at issue (1,492 out of 13,425). (See supra pp. 2-3; Wecker Report at 4-5 & Appx. A.) Based on that mathematical fact, Dr. Cowan's sample was statistically invalid and Mr. Holt's opinion cannot be extrapolated beyond the 424 loans he reviewed (even if his conclusions about those 424 loans were reliable, which they were not). See, e.g., Certified Eng'g, 2009 WL 1324047, at *5; Chavez, 2004 WL 5520002, at *8-11.

Second, even if the initial sample of 2,387 loans had been selected randomly—and it was not—the subsequent non-random and biased selection process for the 424 loans actually underwritten by Mr. Holt likewise requires exclusion of Mr. Holt's and Dr. Cowan's testimony. Dr. Cowan provided his sample of 2,387 loans to Mr. Holt for re-underwriting. (Cowan Report at 7.) He played no role in selecting the subset of 424 loans that Mr. Holt actually reviewed. (Holt Report at 34.) That selection process was done entirely by Mr. Holt, who does not even purport to have the necessary

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statistical expertise to construct a random sample. Nevertheless, and despite his lack of involvement in the selection process, Dr. Cowan states that the 424 loans that Mr. Holt did underwrite "are random subsets of the full set of loans selected". (Cowan Report at 7.) But neither expert explains how Mr. Holt selected the 424 loans to ensure they constituted a "random" sample. That failing alone violates Rule 26 and requires exclusion of the proffered testimony. See Fed. R. Civ. P. 26(a)(2)(B)(i) (expert report must include "a complete statement of . . . the basis and reasons for" the expert's opinion); see also Many Cultures, 2011 WL 5515515, at *15 (proponent of expert testimony has burden to demonstrate admissibility).

In fact, Dr. Cowan's assertion that the 424 loans are a "random subset" is demonstrably false. That subset includes no loans from six of nineteen loan groups in the securitizations at issue and 193 of Dr. Cowan's 303 loan strata. (Wecker Report at 20.) The probability of a randomly selected sample missing such large portions of the loan population is virtually zero—to the point of being a mathematical absurdity. As Defendants' statistical expert, Dr. Wecker, explains:

> If . . . a sample of 424 (Holt's sample size) were selected at random, the chance that at least one of the 424 loans would fall into one of the strata completely missed by Holt's sample is 0.9999999999 . . . followed by 173 more 9's—meaning that it is virtually impossible to select 424 loans at random from 13,425 loans and fail to select a single sample loan from one of the strata completely missed by Holt's sample. (Id. at 20-21.)
> . . . .
> [T]he probability of a distribution of loans as dramatically non-representative as the Holt 424 arising as a random subset of Dr. Cowan's sample is less than 1 in 10^{140} . . . . A chance of one in 10^{140} is unfathomably small and impossible to compare to anything in normal experience, as there are only an estimated 10^{87} particles in the observable universe. By comparison, a chance of one in a billion is only one in 10^{9}; one in a trillion is only one in 10^{12}; one in 10^{140} is incomparably larger yet . . . . (Id. at 7, 21.)

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Tellingly, in addition to not being random, the 424 loans reviewed by Mr. Holt constituted a severely biased sample favoring the inclusion of loans with low FICO scores. Specifically, while approximately 25 percent of the loans in Dr. Cowan's sample of 2,387 came from each of his four FICO score quartiles, 42.7 percent of the loans that Mr. Holt re-underwrote came from the lowest FICO score quartile. (Wecker Report at 22, 32.) That is especially significant because Mr. Holt opined that over 50 percent of the loans he reviewed from that quartile (92 out of 181) were "materially defective", as opposed to, for example, only 25 percent of the loans from the highest FICO score quartile (26 out of 104). (Id.) Mr. Holt's heavier weighting towards the lowest FICO score loans inflated the overall percentage of loans he deemed "materially defective".

For each of those independent reasons, Mr. Holt did not review a statistically valid, random sample of the loan population. Accordingly, his review of a non-random sample of 424 loans provides no reliable basis for Dr. Cowan to extrapolate that approximately 37 percent of the broader loan population is "materially defective". See, e.g., United States v. W.R. Grace, 455 F. Supp. 2d 1181, 1189 (D. Mont. 2006) ("A random sampling of the population is necessary to allow the results among participants in a study to be extrapolated to predict results in a broader population."); U.S. Info. Sys., Inc. v. Int'l Bhd. of Elec. Workers Local Union No.3, AFL-CIO, 313 F. Supp. 2d 213, 233 (S.D.N.Y. 2004) ("the reliability of any analysis depends upon an unbiased selection of sample data").

The facts here are analogous to those in Certified Engineering. That case involved a contractual dispute about an order for approximately 300 copy machines. In an attempt to support its contention that the copiers met or exceeded the warranted condition, the seller offered the expert testimony of a technician who inspected a sample of approximately twenty of the copiers at issue. 2009 WL 1324047, at *2. The proposed

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expert explained that he inspected at least one copier from each room in the warehouse and inspected both easily accessible and less accessible copiers. Id. The court permitted the proposed expert to testify about the condition of the twenty copiers he had personally inspected, but excluded the portion of his testimony that extrapolated the condition of the copiers as a whole from the twenty in his sample. Id. at 5. The Court noted that while the expert's methodology indicated "an attempt at randomness" his failure to inspect a "scientifically random" sample rendered any extrapolation unreliable. Id.

Likewise, because the 424 loans reviewed by Mr. Holt were not a scientifically random sample of the total population of loans, Dr. Cowan's proposed extrapolation of Mr. Holt's conclusion to the full population of loans is not "the product of reliable principles and methods" and must be excluded. Fed. R. Evid. 702; Chavez, 2004 WL 5520002, at *8-11.

Moreover, although the expert in Certified Engineering was allowed to testify about the twenty copiers he examined, allowing Mr. Holt to testify even about the 424 loans he reviewed would be both non-probative and highly prejudicial in violation of Federal Rules of Evidence 401 and 403. In Certified Engineering, the fact finder could conclude that some copiers met the warranted condition and others did not, with contractual relief apportioned depending on the findings. Here, however, the central issue to be decided is whether WMB's underwriting guidelines "ceased to exist", and thus an opinion regarding the quality of WMB's underwriting that is limited to only 424 loans—or about three percent of the total population—would be irrelevant and meaningless absent the ability to extrapolate Mr. Holt's conclusions to the other 13,000 loans. Indeed, as Plaintiffs have previously conceded, "Whether different aspects of WaMu's uniform underwriting standards were applied to specific loans is immaterial because the underwriting standards that are being challenged were, according to the

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Offering Documents, uniformly applied across all loans in each pool". (Pls. 12(c) Opp. at 2 n.6.) There can be no legitimate dispute that Mr. Holt's purported 178 "materially defective" loans—i.e., less than 1.5 percent of the total population—cannot constitute evidence of an "absence of underwriting standards" at WMB. In re Wamu, 748 F. Supp. 2d at 1255. And, here, unlike in Certified Engineering, there is demonstrable bias in the sample, which renders unreliable Mr. Holt's opinion even as to the 424 loans he reviewed. (See supra 8-9.)

Mr. Holt's opinion about the 424 loans would also be misleading and highly prejudicial to Defendants because the jury would naturally conclude that Mr. Holt's conclusion that 37.1 percent of those loans were "materially defective" could be applied to the population at large—for if it did not, what would be the point of his testimony in a case about an alleged systematic abandonment of underwriting "across all loans in each pool"? (Pls. 12(c) Opp. at 2 n.6; see Fed. R. Evid. 403; Ram v. N.M. Dep't of Evn't, No. 05-cv-1083 JB (WPL), 2006 U.S. Dist LEXIS 95369, at *53 (D.N.M. Dec. 15, 2006) ("because of the small size of the data sample at play in this case . . . the evidence poses a significant risk of confusing the issues or misleading the jury"); Recreational Devs. of Phoenix, Inc. v. City of Phoenix, 220 F. Supp. 2d 1054, 1061 (D. Ariz. 2002) (excluding statistical evidence where "the probative value of such evidence is far outweighed by its potential to mislead and confuse the factfinder").)

III. Mr. Holt Should Be Precluded From Offering the Opinion That Certain Loans He Reviewed Were "Materially Defective" Because He Did Not Properly Apply WMB's Underwriting Guidelines.

Mr. Holt's testimony also should be excluded for the independent reason that it is unreliable and not relevant to any issue in this case because he did not actually apply WMB's underwriting guidelines. Mr. Holt claims that he sought to determine whether the loans in his sample "deviated from the requirements of WMB's

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[underwriting guidelines]". (Holt Report at 2.) However, in reaching his opinion as to whether the loans he reviewed were "materially defective", what Mr. Holt actually did was create rules that are inconsistent with or directly contradict the applicable WMB guidelines.

First, Mr. Holt states that "[u]nder the WMB guidelines" all loans with the potential for negative amortization—i.e., loans such as Option-ARMs where the borrower had the option to pay less than the interest owed each month, with the unpaid interest then added to the principal amount owing—required: (i) an upward adjustment of one percent of the qualifying interest rate used to calculate the Debt-to-Income ("DTI") ratio and (ii) an upward adjustment of the mortgage loan amount used in the DTI and Loan-to-Value ("LTV") ratio calculations to at least 110 percent of the actual loan amount, due to the potential for the principal to increase over time. (See Holt Report at 18; Ostendorf Report ¶ 130.) But Mr. Holt does not cite any particular provision of the WMB guidelines in support of that "rule" and, in fact, the guidelines contain no such requirement—even among the detailed provisions they do contain regarding how to calculate DTI and LTV. (See, e.g., 8/17/06 CUG at 1-23, 1-32, 6-11 to 6-15; Ostendorf Report ¶ 130.) As a result, Mr. Holt's calculation of the DTI and LTV ratios for purposes of evaluating every loan in his sample that had the potential for negative amortization (172 out of the 424 loans) was wrong. (Ostendorf Report ¶¶ 130-32.) Furthermore, imposition of that arbitrary "rule" had profound consequences throughout Mr. Holt's analysis in that it affected not only the DTI and LTV ratios, but also other metrics that are derivative of the same calculations. (Id. ¶ 131.)

Given that his methodology miscalculated numerous metrics for loans with the potential for negative amortization, it is not surprising that such loans make up 61 percent of all the loans that Mr. Holt opined were "materially defective" (109 out of

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178) even though they only comprised 41 percent of his sample. (Id. ¶¶ 131-32.) But those loans were only "defective" in the sense that they did not comply with a rule that Mr. Holt invented, not a requirement of the WMB guidelines.

Second, Mr. Holt systematically and improperly reduced the value of retirement account assets used to determine if borrowers held the required liquid reserves. (Id. ¶¶ 166-67.) Mr. Holt applied a 30 percent reduction to borrowers' retirement account assets, despite the fact that WMB's guidelines specifically mandated only a 20 percent reduction. (See, e.g., 8/17/06 CUG at 5-24 ("[a] deduction of 20% from the vested balance must be taken into account for penalties and taxes, if applicable").) That methodological error affected Mr. Holt's analysis of every loan in which the borrower's reserves consisted at least in part of retirement assets, such as 401(k) accounts (at least 39 out of 178 "materially defective" loans, according to Mr. Holt's data). (Ostendorf Report ¶ 166; Holt Survey Data at Sheet 2, Column IJ.)

Third, Mr. Holt consistently committed a methodological error in evaluating the reasonableness of "stated income" in the loan files. "Stated income" refers to certain reduced documentation loan programs in which—as disclosed in the Offering Documents—the income stated by the borrower on the loan application was not required to be documented. Mr. Holt describes his approach as follows:

> The Guidelines in force in 2004 to 2006 required underwriters to check incomes for reasonableness, but provided no practical guidance on how to do so. I therefore developed an approach to reviewing the reasonableness of stated income based on my experience as an underwriter and on industry norms for determining whether an income was reasonable.

(Holt Report at 19.) To solve that purported problem, in every instance Mr. Holt relied on average salary statistics from the Bureau of Labor Statistics of the U.S. Department of Labor ("BLS") to review the reasonableness of stated income loans: "When my team and I reviewed stated income loans, I selected the closest possible BLS-listed occupation to

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the occupation listed by the borrower on the application, and looked for income ranges in the borrower's location where possible." (Holt Report at 20.)

That approach contradicts WMB's guidelines, which instructed underwriters to evaluate the stated income "for reasonableness based on the borrower's credit profile". (8/17/06 CUG at 1-14 (emphasis added).) According to the guidelines, the "initial loan application, which may not be altered, is the primary source of information used to evaluate the borrower's income, profession, and tenure in conjunction with assets, liabilities, and net worth. This information is used to evaluate the reasonableness of the stated income and the borrower's financial capacity." (Id. at 1-13 (emphasis added).) "If there is information in the file that appears to refute or contradict the level of income stated by the borrower, the Credit Approver should require additional documentation." (Id. at 4-3 (emphasis added).) Thus, WMB underwriters were supposed to determine reasonableness of stated income by considering other factors within the loan application, such as borrower's assets and credit history, to determine whether they were consistent with the stated income, and if those factors were consistent, the inquiry was at an end. By substituting reliance on the BLS statistics for the judgment of the underwriters based upon the contents of the loan file, contrary to the WMB guidelines, Mr. Holt's opinion does not even speak to the relevant question of whether WMB's guidelines "ceased to exist".

Fourth, in many instances, Mr. Holt simply applied the wrong guidelines. WMB utilized multiple sets of guidelines with different requirements, including specialized manuals for particular channels—Wholesale, Retail or Premier Broker—and updated its guidelines multiple times per year. (Ostendorf Report ¶ 172.) On at least 23 loans, Mr. Holt applied the guidelines for the wrong channel or the wrong date or both. (Id.)

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Finally, Mr. Holt imposed artificial and overly restrictive limitations on the use of "compensating factors"—i.e., factors that, under the WMB guidelines, had to be considered in conjunction with the loan file as a whole to determine whether a borrower's application substantially complied with the underwriting guidelines, even if certain individual criteria were not satisfied. In considering compensating factors, Mr. Holt relied on what he called "rules of thumb" that he did not even purport to draw from WMB's guidelines. While there is nothing categorically improper about using "rules of thumb" in analyzing inherently subjective and discretionary issues such as compensating factors in mortgage applications, the rules employed by Mr. Holt expressly contradicted the dictates of the WMB guidelines. Most notable are the following:

- "[I]n general, in my experience, a borrower must have verified reserves of a minimum of six to twelve months to constitute a compensating factor, and depending on the other facts of the loan a much higher level of reserves may be required"; and
- "[A]s a general rule of thumb, a borrower must have a FICO of at least 700 for it to constitute a compensating factor, and depending on the other aspects of the loan a much higher FICO may be required".

(Holt Report at 31-32.)

With respect to verified reserves, the WMB underwriting guidelines stated that any amount "in excess of product guidelines" (which were often as low as two months' worth of a borrower's mortgage payment (see, e.g., 8/17/06 CUG at 5-5)) could serve as a compensating factor (see, e.g., id. at 1-57). But Mr. Holt's report states that "six to twelve months"—or even "a much higher level"—of reserves were required. (Holt Report at 32.) And even beyond the disclosure in his report, Mr. Holt's survey only permitted his team to deem it a compensating factor if the borrower had "12 or more months" of verified reserves. (Holt Survey at Question 11.)

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Likewise, the WMB underwriting guidelines state that any FICO score "significantly higher than the program minimum" may be deemed a compensating factor. (See, e.g., 8/17/06 CUG at 1-57.) But Mr. Holt instead required a fixed score of 700 or higher, failing to account for variations in the minimum FICO score requirements for different loan programs, which were often as low as 620. (See, e.g., 8/17/06 PPG at 3-13; Uniloc USA, Inc. v. Microsoft Corp., 632 F.3d 1292, 1315 (Fed. Cir. 2011) (reversing the district court's failure to exclude expert testimony where a proffered expert relied on a "rule of thumb" for calculating patent infringement damages, but "fail[ed] to tie the theory to the facts of the case").)

Because Mr. Holt purported to base his opinion on WMB's underwriting guidelines, but for all of the above reasons did not faithfully apply those guidelines, his opinion was not "the product of reliable principles and methods" and should be excluded. Fed. R. Evid. 702; Metabyte, Inc. v. Canal+ Techs., S.A., No. C-02-05509 RMW, 2005 WL 6032845, at *5 (N.D. Cal. June 17, 2005) (excluding expert testimony based in part on failure to adhere to contractually prescribed valuation methodology); In re Live Concert Antitrust Litig., No. 06-ML-1745-SVW (VBK), 2012 WL 1021081, at *18-20 (C.D. Cal. March 23, 2012) (excluding expert testimony that failed to adhere to the applicable methodology for defining relevant product markets that the expert claimed to have used).

In addition to not being reliable, Mr. Holt's opinion is irrelevant because the central issue in this securities case is whether the Offering Documents contained false or misleading statements regarding whether the loans underlying the securitizations generally were underwritten in accordance with WMB's underwriting guidelines. If Mr. Holt did not apply the WMB guidelines—and, for the reasons explained above, he did not—his proffered expert opinion is nothing more than his subjective judgment about

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whether the loans he reviewed should have been made pursuant to a set of standards that he considers to have been appropriate. (See Holt Report at 4.) But this case is not about whether Mr. Holt would have made the loans at issue, or about what he believes WMB's underwriting guidelines should have been; rather, it is about whether WMB systematically abandoned the underwriting guidelines it in fact had in place at the time. Mr. Holt's testimony thus has no relevance—or "fit"—to any issue in this case and would not be helpful to the jury. As the Supreme Court put it in Daubert, "Expert testimony which does not relate to any issue in the case is not relevant and, ergo, non-helpful." 509 U.S. at 591.

Indeed, because of the qualitative and subjective nature of loan underwriting, even a single significant deviation from WMB's guidelines—let alone the numerous ways in which Mr. Holt applied rules that are inconsistent with those guidelines—makes it impossible to determine how many of Mr. Holt's conclusions regarding particular loans would have been different had he properly applied WMB's guidelines, as he purported to do and as the standard articulated by the Court requires. There is no way to disentangle that portion of Mr. Holt's analysis that contradicts the WMB guidelines; his opinion must be excluded as a whole.

The Metabyte case is analogous. The issue there was the appropriate valuation of a tranche of common stock subject to a put option. 2005 WL 6032845, at *1. The put option required that any valuation of the common shares be performed in accordance with seven specific valuation practices and assumptions. Id. Although the party offering the testimony argued that "in his valuation, [the expert] considered, and utilized where appropriate, seven criteria prescribed in the Put Option", the court found that the expert did not follow those requirements, explaining that, "although [the expert] recites the Put Option's criteria on page twelve of his expert report, he never mentions

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them again". Id. at 5. Based in part on his failure to apply the relevant valuation guidelines, the court excluded the expert's testimony. Id.

As in Metabyte, Mr. Holt claims to have utilized the applicable WMB underwriting guidelines, when, in fact, his analysis deviated from those guidelines and contradicted them in numerous significant ways. As a result, Mr. Holt's conclusions amount to nothing more than an opinion whether he would have made the loans in question according to his own standards, not the standards prescribed in the applicable WMB underwriting guidelines relevant to the determination of liability in this action. Mr. Holt's proffered testimony therefore does not "fit" any issue to be determined in this case and should be excluded as irrelevant. See Daubert, 43 F.3d at 1320 ("Rule 702's 'helpfulness' standard requires a valid scientific connection to the pertinent inquiry as a precondition to admissibility.").

CONCLUSION

For the foregoing independent reasons, and on the basis of the authorities cited, Defendants respectfully request that the Court exclude the proffered expert testimony of Dr. Charles Cowan and Mr. Ira Holt.

Dated this the 25th day of April, 2012.

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